IV Options for Debt Reduction and the Selection of Countries

Existing Instruments

That multilateral debt reduction and relief is needed was recognised some time ago with multilaterals resorting to rescheduling and refinancing operations to ease the multilateral debt service burdens of borrowers who risked falling into protracted arrears. The need was explicitly recognised by the World Bank when it established, at the urging of Nordic governments, the fifth dimension facility in 1988 (Mistry: 1994). That facility subsidises 90% of the interest on IBRD loans being serviced by eligible severely-indebted low-income countries (SILICs) which are undergoing adjustment programmes and meet conditionality tests.

Since its establishment, the fifth dimension has provided special IDA allocations averaging $150-200 million annually to eligible countries to help them meet the bulk of their IBRD *interest* obligations. In 1995, supplemental IDA allocations of $186 million were provided to fourteen eligible countries to help them cover the bulk of their interest payments to IBRD. Discussion of a sixth dimension, designed to cover IBRD *principal* repayments, have been ongoing for some time but some of the problems such a facility poses have not yet been satisfactorily resolved. It appears unlikely that they will be (Mistry: 1994).

Similarly, the IMF's establishment of SAF, its subsequent efforts to fund ESAF-1 and ESAF-2 (by pre-empting a portion of budgeted aid flows) and its efforts to find the financing to entrench ESAF as a permanent facility in the IMF's armoury of instruments also reflect, in part, its implicit concern with the growing dimensions of the multilateral debt problem (Killick: 1995; Martin: 1996; Mistry: 1994). But the IMF's enchantment with a permanent ESAF also reflects its institutional desire to remain permanently involved in monitoring and supervising the macroeconomic affairs of SILICs by having assured access to development-type concessional funding of the kind that was not earlier envisaged as being part of the IMF's original or amended charter. Nevertheless, the odds are in favour of ESAF becoming permanently established with its interest-subsidy fund being financed through donor contributions, the sale of a small fraction of the IMF's gold reserves, or both (Killick: 1995; Martin: 1996; Mistry: 1994).

Although these special facilities which the Washington-based international financial institutions (IFIs) have now established acknowledge – by virtue of

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their existence – the presence of a multilateral debt problem, both the IMF and the World Bank appear to be attempting to use the problem opportunistically in a way which serves their own internal agendas. They appear to be more interested in minimising the extent of the problem and pointing to solutions designed to accommodate their institutional interests as creditors rather than meeting the legitimate needs of the affected heavily-indebted low-income countries. In that respect, their recent second-round analysis of the need for multilateral debt reduction and relief (MDRR) undertaken in 1996 (IMF/WB: 1996a,b), at the urging of the Development Committee, differs little in its motivation from the first-round analysis undertaken earlier (World Bank: 1994a; World Bank: 1995a; IMF/WB: 1995a,b) although it represents a substantive improvement in quality.

Alternative Options

Alternative options for multilateral debt reduction and relief hinge on whether they can be funded without: (a) damaging the financial standing of the multilaterals; and (b) imposing excessive additional burdens on bilateral donors – who are also IFI shareholder governments – by remaining within the existing envelope of ODA resource availability. This section quickly revisits the principal options available and refers to analyses in which they have been more fully dealt with.

Using the World Bank's Provisions and Reserves

Despite opposition from World Bank itself, other financial analyses (Hardy: 1995; Killick: 1995; Martin: 1996; Mistry: 1994, 1995a, 1995c; Vadera: 1995) conclude that it would be possible – without damaging the Bank's financial standing, risking any adverse impact on its credit rating or increasing its borrowing costs – to draw down on a fraction of its accumulated provisions, reserves and currency translation gains in writing down IBRD debt owed by the smaller African and other severely-indebted low-income countries (SILICs) whose circumstances justify multilateral debt stock reduction. The impact would be more difficult to absorb if the larger SILICs (such as Cote d'Ivoire and Nigeria) were to be included and could raise problems if the total amount of debt stock reduction charged against the IBRD's balance-sheet were to exceed $4-5 billion.

Using IDA Resources

As these resources have been donated in perpetuity from budgetary resources by OECD, Arab-OPEC, other developing countries, as well as the IBRD

itself (from its profits), on a revolving basis, the options which exist in utilising IDA resources imaginatively to reduce debt burdens through a combination of: debt cancellation, rescheduling, and retroactive terms adjustment, are far greater than those available from the IBRD's resources which are mostly market-derived and market-sensitive. The principle of using IDA funds to a limited extent for multilateral debt reduction and relief (MDRR) has already been established with the creation of the fifth dimension facility.

The obvious cost in using IDA funds for MDRR involves the extinction (or further flay in the use) of funds that are supposed to revolve in the future to the benefit of poorer countries which would be the main beneficiaries of inter-temporal transfers. However, since the intended future beneficiaries are, in most instances, the same SILICs which are affected by an unsustainable multilateral debt burden, it would be justifiable to use a fraction of available IDA resources, and reflows from previous credits which have already begun revolving, to finance MDRR. Allowing for the use of up to 5% of total available IDA resources for this purpose would enable a further $5-6 billion to be applied to MDRR. Moreover, rechannelling IDA commitments away from larger semi-industrialised Asian countries, which no longer require such resources as urgently as other claimants with fewer external financing options, would release even more funds than are currently under discussion (see: Killick: 1995; Martin: 1996; Mistry: 1994, 1995a).

Using IMF Gold Reserves

This option too has been examined recently by independent analysts (Killick: 1995; Martin: 1996; Mistry: 1994, 1995a, 1995c). It has also been considered by IMF staff who appear inclined in favour of gold sales, but not to finance MDRR. A precedent for gold sales was set when the IMF's original Trust Fund (the precursor to SAF and ESAF) was established in the mid-1970s. The general conclusion of the more recent analyses of gold sales and their implications, is that it would be possible, perhaps even desirable, to sell or pledge between 10-15% of the IMF's ample gold reserves of 103 million ounces. These are still valued on the IMF's books at $35 per ounce and thus vastly understate – by 90% – the present market dollar value of these reserves. Such sales would raise between another $4-5 billion at present world market prices.

There is emotive political opposition from some influential shareholders of the IMF and from gold-producing countries (worried about price effects in the world gold market) to sell any IMF gold for any purpose. But there is no sound economic or financial reason for not doing so, taking a global welfare viewpoint. The sequestration of these reserves which presently earn no interest, and serve no useful purpose sitting in vaults, is difficult to justify on eco-

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nomic grounds. However, the uses to which the dollar proceeds of such gold sales may be applied are a matter of considerable contention (Killick: 1995; Martin: 1996; Mistry: 1994; Mountfield: 1996). The orthodox institutional view is that such proceeds should be applied to enhance the terms of ESAF thus making it more concessional or to provide bridge finance until ESAF is permanently endowed.

The less orthodox view (held by those outside of the multilateral system and by debtors) is that all or part of the proceeds should be used to directly finance reduction of the IMF's outstanding upper-tranche (GRA) debt stocks in SILICs with an unsustainable debt problem. As usually happens in the international financial system, the orthodox view is likely to prevail for now. While that would result in sub-optimal outcomes from the viewpoint of efficiency and achieving the necessary level of MDRR, it would still have a small indirect effect on providing some relief by enabling greater amounts of ESAF to be used for refinancing GRA debt and alleviating further the burdens of debt service by making ESAF's present terms more concessional (Clarke: 1995).

Issuing a New Allocation of SDRs

Although this option remains the most appealing conceptually, and would enable the necessary resources to be raised with no additional burdens on bilateral budgets or multilateral balance-sheets, it is powerfully opposed by influential shareholders of the IMF (notably Germany and Japan) on the grounds that it constitutes recourse to a potentially inflationary soft-option. Though a considerable amount of analysis has been carried out on the subject by a variety of authoritative sources, it remains a political non-starter for the time being (Killick: 1995; Martin: 1996; Mistry: 1994). Moreover, while a new SDR allocation would of itself be a relatively simple exercise, the use of such an allocation for MDRR would be more complicated requiring the establishment of a subsidy account which would require separate funding.

Resources within the African Development Bank System

Unlike the World Bank, the African Development Bank has few internal resources on which to rely for the reduction of its outstanding multilateral debt to sub-Saharan SILICs. The provisions and reserves of the hard-loan window of the African Bank are inadequate to accommodate the severity of its portfolio problems. They could not be drawn down to finance MDRR without severely impairing the financial integrity of that institution (Mistry: 1993a, 1995b). On the contrary, they need to be built-up substantially over a number of years before they reach levels comparable to those of the World

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Bank or the other regional multilateral development banks. Like IDA, the soft-loan window African Development Fund could deploy some of its resources for MDRR but it does not have any internal cushions (as does IDA), nor a sufficiently large base as yet of reflows to apply immediately for MDRR. It would need to allocate a portion of its future commitment authority, financed from the next AfDF replenishment (AfDF-7), for MDRR provided that donors were willing to contribute for such a purpose. This would, in effect, mean relying on the budgetary resources of donors to fund MDRR in the case of the African Development Bank. Application of the same 5% rule as for IDA (on the grounds that AfDF and IDA are equivalent facilities funded largely by the same donors) to AfDF resources would yield less than $350 million for MDRR purposes.

Incremental Bilateral Resources Provided by Donor/Shareholders

In addition to resources for MDRR available within the multilateral system, which together amount to between $13-15 billion, bilateral donors could channel the resources they presently use to cover multilateral debt service obligations for selected SILICs, more directly into a more organised facility for dispensing MDRR on a global rather than an institution-by-institution basis. Apart from the contributions made to multilateral soft-loan windows which have refinanced hard-window obligations, overtly or covertly, several bilateral donors have made special contributions to various debt relief facilities – such as for example the fifth dimension, or to individual country facilities such as the Uganda Multilateral Debt Fund (Martin: 1996). They have also made *ad hoc* annual contributions to help individual SILICs cover their multilateral debt service on a case-by-case basis. Bilateral contributions earmarked specifically for multilateral debt relief have been estimated at $2 billion (Martin: 1996) while bilateral contributions towards all kinds of debt relief have been estimated at $9 billion (Killick: 1995; Mountfield: 1996) annually depending on which kinds of contributions are counted as being for what purpose. Taking the $2 billion estimate as the benchmark for bilateral support would increase the total availability of resources for MDRR to between $15-17 billion; more than sufficient to deal with the multilateral debt overhang problem efficiently and up-front (Martin: 1996; Mistry: 1995a).

The Proposed Multilateral Debt Facility

The Multilateral Debt Facility (MDF) idea mooted, but presently put in abeyance, by the World Bank provides a sound conceptual model (in its broad outline but not in its detailed architecture) towards which the interna-

tional community should move in attempting to resolve the multilateral debt overhang problem. Such a global facility is needed for MDRR to be applied on an equitable and objective basis without political considerations intruding excessively into MDRR decisions. It is also needed to address the critical problem of restoring the financial credibility of the African Development Bank as a creditor and of its borrowers as debtor-shareholders. To work well such a facility would need to be mirrored at the national level by a fund similar to that fashioned by Uganda to rationalise its overall debt service and prioritise its payments to multilateral creditors (Government of Uganda: 1995; Martin: 1996).

An MDF is essential to prevent the present, unsatisfactory piecemeal institution-by-institution approach from becoming entrenched as the only way out. That would result in sub-optimal outcomes which would drag out the crisis for much longer than is necessary. The present *ad hoc* approach damages debtor countries and compromises the financial stability of the multilateral institutions. It imposes intolerable annual demands on bilateral donors for grant assistance at levels which their present budgetary circumstances simply will not permit.

The problem with the original MDF was that its conceptual appeal was vitiated by the detailed design proposed which attempted to result in the World Bank having its cake and eating it too. The World Bank's presentation of the MDF appeared to suggest that it would deal with debt-stock reduction of $11 billion equivalent up-front, when in reality (reading the fine print) it resulted in covering only the debt service payments of twenty-four SILICs with unsustainable multilateral debt burdens for the next 15 years. In nominal terms, these amounted to reducing the multilateral debt stock by just $2.8 billion and covering related interest payments of $1.2 billion, i.e. a total of only $4 billion over 15 years.

The way in which the MDF was presented attempted to convince debtors and the international community that it would result in substantial MDRR up-front. At the same time it tried to placate the Bank's shareholders by convincing them that the MDF would not cost much and that payments to fund it could be made over a long period of time. These opposite messages created difficulties which resulted in the MDF tripping over itself when it was unveiled. The World Bank's attempt to be too-clever-by-half (Mistry: 1995a) resulted, unfortunately, in the baby being thrown out with the bath water when the Bank was confronted with a barrage of criticism, from within and without, triggered by misleading, premature global publicity about its, quite literally, half-baked proposal.

The type of MDF proposed by the World Bank would have been a sub-optimal, feeble response to the multilateral debt problem. But a more robustly constructed MDF, which was more candid about: what it intended to

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achieve, the amount of resources it would require for up-front debt stock reduction and longer-term debt service relief, and how it would be funded (Mistry: 1995a), might have received a more favourable reception and attracted greater global support. Such an MDF should still be the aim of the international community to achieve in dealing resolutely with the multilateral debt overhang.

The Selection of Countries

The World Bank's 1995 analysis – undertaken in connection with its temporarily frozen proposal for a Multilateral Debt Facility concluded that there were twenty-four countries in need of MDRR (World Bank: 1995a); of which eighteen were in SSA. By contrast, the January 1996 analysis of the problem by the IFIs (IMF/WB: 1996b) concludes that: there are eight countries with an unsustainable debt overhang, and another twelve countries which are possibly stressed; and three countries which are likely to need MDRR. The reference to the possibly stressed appears to be an attempt by the IFIs to square the analytical circle in reconciling their own internal differences of opinion; especially those between the staff of the Bank on the one hand, and that of the Fund on the other.

As the IFIs themselves acknowledge, there are problems with the methodology and assumptions used for assessing debt sustainability. These are recounted in the IFIs' analytical papers and in a useful recent report for the Group of 24 (Martin: 1996). As many of these problems, especially concerning the selective use of assumptions, were dealt with (Eurodad: 1995a,b; Hardy: 1995; Killick: 1995; Mistry: 1995a; Oxfam: 1996) in the context of the earlier 1995-IFI analysis (IMF/WB: 1995a,b) it would be tedious to repeat or examine them at length again here. Briefly, they concern the use of assumptions to derive conclusions which the IFIs appear to have started out with, rather than as judgements arrived at after genuinely impartial, unbiased inquiry.

They also concern: continually moving goal-posts when it comes to cut-off points for certain criteria (e.g. the debt-to-exports cut-off shifting from 200% to 225% to 250%, and the debt service-to-exports ratio cut-off shifting from 10% to 15%); the use of over-optimistic assumptions about future independent external private and public flows to SILICs which will make their debt service sustainable; what should be considered extraordinary and what is normal in taking such external flows into account; insufficient regard for the fiscal sustainability of debt service despite rhetorical flourishes in that direction; and disregard for levels of aid dependency in sub-Saharan African debtor economies which are already too high and which need to be reduced rather than increased simply to service multilateral debt.

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A careful review of the IFI analysis suggests that, in the end, the choice of which countries to place in which category is more a subjective than objective matter. This is mainly because attempts to draw out objective, unarguable indicators of sustainability through debatable projections for the next 10 years, on the basis of assumptions which do not relate to actual experience over the previous 5-10 years, are inevitably artificial and belaboured. Using that approach and methodology it is entirely possible to arrive at any conclusion one is predisposed to arriving at. It is possible, using the same evidence, but different interpretations, to arrive at different conclusions as Martin (1996) has demonstrated. The conclusions of different IFI analyses and those conducted by Martin (1996) and the author (for this study) are shown in Table 8 below.

These conclusions need to be interpreted carefully. The IFI analyses attempt to exclude as many countries as possible, unless the sustainability analysis overwhelmingly suggests otherwise. The Martin and Mistry judgements are inclusive to the extent that the analytical data suggest a need to err on the side of giving debtors rather than creditors the benefit of any analytical doubt. There are at least six sub-Saharan countries (Cape Verde, Comoros, Djibouti, Gabon, Gambia and Lesotho) on which no analysis is available other than the three countries which the 1996-IFI analysis classifies as not yet determined. Of these, three (Cape Verde, Comoros, Gabon) could be sufficiently debt-distressed to warrant the application of MDRR but detailed analysis is needed to confirm that preliminary judgement.

As noted earlier, the 1996-IFI analysis shows eight countries in need of definite MDRR and twelve countries in need of possible MDRR – with three additional countries whose debt sustainability has not yet been determined but which could fall into either the unsustainable or possibly stressed categories. The Martin analysis, using the same evidence as the IFIs, increases these numbers to eighteen with unsustainable debt burdens and ten which are possibly stressed respectively. The Mistry (current) analysis – which looks not only at the debt stocks/exports and debt-service ratios but also at fiscal sustainability and aid dependency ratios – concludes that: (a) twenty countries are in need of multilateral debt stock reduction combined with rescheduling of residual stock on intermediate terms; with (b) a further twelve countries which do not need debt stock reductions but require some form of multilateral debt rescheduling or refinancing to make their future debt service burdens more tractable. That analysis is disinclined to accept the possibly stressed category because it is an all-too-convenient IFI device to dodge the main issue, rather than an analytically respectable intermediate category. With very few differences, the Martin and Mistry analyses are virtually congruent, and are based on much the same information as used by the IFIs, but they lead to substantially different conclusions from those of the IFIs.

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Table 8 **Countries in Need of Multilateral Debt Stock Reduction**

	WB/MDF Analysis 1995	**IMF/WB Analysis 1996**	**Martin Analysis 1996**	**Mistry Analysis 1996**
SSA:	Burundi	Burundi (U)	Burundi (U)	Burundi (U)
	Cameroon	Guinea Bissau (U)	Cameroon (U)	Cameroon (U)
	CAR	Mozambique (U)	Côte d'Ivoire (U)	Côte d'Ivoire (U)
	Côte d'Ivoire	Sao Tome (U)	Ethiopia (U)	Ethiopia (U)
	Eq. Guinea	Sudan (U)	Guinea Bissau (U)	Guinea Bissau (U)
	Guinea Bissau	Zaire (U)	Madagascar (U)	Liberia (U)
	Madagascar	Zambia (U)	Mozambique (U)	Madagascar (U)
	Mozambique		Sao Tome (U)	Mozambique (U)
	Niger	Cameroon (PS)	Senegal (U)	Nigeria(U)
	Rwanda	Congo (PS)	Somalia (U)	Sao Tome (U)
	Sao Tome	Côte d'Ivoire (PS)	Sudan (U)	Senegal (U)
	Sierra Leone	Ethiopia (PS)	Tanzania (U)	Somalia (U)
	Somalia	Madagascar (PS)	Uganda (U)	Sudan (U)
	Sudan	Niger (PS)	Zaire (U)	Tanzania (U)
	Tanzania	Rwanda (PS)	Zambia (U)	Uganda (U)
	Uganda	Tanzania (PS)		Zaire (U)
	Zaire	Uganda (PS)	Angola (PS)	Zambia (U)
	Zambia		Benin (PS)	
		Liberia (NYD)	Congo (PS)	Angola (R)
		Nigeria (NYD)	Kenya (PS)	Benin (R)
		Somalia (NYD)	Niger (PS)	Congo (R)
			Rwanda (PS)	Kenya (R)
			Sierra Leone (PS)	Malawi (R)
			Togo (PS)	Niger (R)
				Rwanda (R)
				Sierra Leone (R)
				Togo (R)
				Zimbabwe (R)
Other:	Bolivia	Nicaragua (U)	Guyana (U)	Guyana (U)
	Guyana		Honduras (U)	Honduras (U)
	Honduras	Bolivia (PS)	Nicaragua (U)	Nicaragua (U)
	Nicaragua	Guyana (PS)		
	Myanmar	Myanmar (PS)	Bolivia (PS)	Bolivia (R)
	Vietnam	Myanmar (PS)	Myanmar (PS)	Myanmar (R)

Key: U = Unsustainable Multilateral Debt Burden
PS = Possibly Stressed
R = Rescheduling of Residual Stock on Soft/Long Terms Needed
NYD = Not Yet Determined

Obviously the inclusion of large borrowing countries with a high proportion of their debt owed to private creditors, like Cote d'Ivoire and Nigeria, as candidates for multilateral debt stock reduction will raise major difficulties. So will the inclusion of difficult countries like Liberia, Somalia, Sudan and

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Zaire which do not attract much political sympathy from OECD donor countries. Moreover, there is a general antipathy to rewarding leaders of governments with debt stock reduction when evidence of excessive corruption and rent seeking is as rife as it is in most sub-Saharan countries. These concerns pose sensitive, contentious problems which cannot be easily resolved through the application of arbitrary judgement.

The history of debt crisis management since 1982 strongly suggests that the debt weapon has, more often than not, been used strategically as a political tool in the conduct of international economic relations between OECD donor/creditor countries and developing debtor countries especially where the treatment of official debt has been concerned. Perhaps the two most egregious instances of this phenomenon were the bilateral debt stock reduction agreements for Poland and Egypt. Moreover, rightly or wrongly, political conditionality has become increasingly intrusive in shaping relations between aid-donor and aid-recipient countries since the end of the Cold War.

It would therefore be sanguine to pretend that, in selecting sub-Saharan Africa countries eligible for multilateral debt reduction, politics will not play a strong part; it inevitably will. Hopefully, in the case of multilateral debt stock reduction, political considerations will be sensitively blended with economic ones and not overwhelm them. The consequences of using debt reduction as an incentive to prod debtor government behaviour in desirable directions of course carries the clear risk of damaging the interests of precisely those inhabitants whom aid and official debt were originally intended to protect – at least ostensibly. But that is not a new problem. It has to be dealt with pragmatically on a day-to-day basis in virtually every sub-Saharan African country.

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